



What's News in Tax

Analysis that matters from Washington National Tax

IRS Transfer Pricing Teams Must Consult with Competent Authority

March 11, 2019

by Theresa Kolish, Sean Foley, Nick Granado, and Ian Novos, KPMG*

Exam teams are now required to confer with competent authority for audits that could end up in the mutual agreement procedure because of transfer pricing adjustments with a country that is a U.S. treaty partner. This is a positive development for taxpayers because the consultation might eliminate or narrow potential transfer pricing adjustments.

The Large Business and International (“LB&I”) division recently issued guidance mandating collaboration between transfer pricing (TP”) field teams and advance pricing and mutual agreement (“APMA”) personnel.¹ The LB&I directive requires teams in the Transfer Pricing Practice, Cross Border Activities, and the Geographic Compliance Practice to consult with APMA on any exams that may generate transfer pricing adjustments with a country that is a U.S. treaty partner. Taxpayers and their advisors can use this directive to ensure the LB&I TP exam team, early in the process, has considered how the competent authority process will affect any potential adjustment, which may eliminate or narrow adjustments.

The directive describes the early consultation requirement as a transfer pricing risk assessment tool, which will allow the LB&I TP exam team to understand the competent authority’s experience with the

* Theresa Kolish is a managing director in the Economic and Valuation Services (“EVS”) practice. Sean Foley is Global Leader, Global Transfer Pricing Dispute Resolution Services, and a principal in the EVS group of Washington National Tax (“WNT”). Nick Granado is a managing director in the EVS practice. Ian Novos is a managing director in the EVS group of WNT.

¹ Interim Guidance on Mandatory Issue Team Consultations with APMA for Examination of Transfer Pricing Issues Involving Treaty Countries, IRS Large Business and International Division (Feb. 19, 2019).

treaty, the treaty partner, and relevant transfer pricing issues early in the process. Sharing of information and experience by APMA is intended to provide the LB&I TP exam team with useful information for consideration in their selection and development of transfer pricing issues.

It is anticipated that an increased level of cooperation between the LB&I TP exam teams and APMA personnel will lead to efficiencies in the transfer pricing examination cycle, as well as consistent transfer pricing positions across the IRS.

The LB&I directive provides that an early consultation is an important step in developing adjustments that are consistent with the arm's length standard under the relevant regulations and tax treaties. The directive notes that adjustments should also be consistent with the U.S. competent authority's commitment to the "implementation of the administrative processes that promote the prevention and timely resolution of treaty-related disputes" as set forth in the OECD's Final Report on Action Item 14 (*Making Dispute Resolution Mechanisms More Effective*). An early consult also provides the LB&I TP exam team an opportunity to understand how APMA would develop the facts or arguments, and based on APMA's experience, may lead the LB&I TP exam team to withdraw the adjustment in full or part. Depending on the facts of a transfer pricing issue, the directive contemplates that additional consults may be needed for certain cases on a go-forward basis.

Under the LB&I directive, LB&I TP exam field team managers, upon starting an examination involving a treaty partner, are instructed to send an email to an "LB&I APMA Consult" designated email box. The APMA consult request will include the taxpayer's name, tax year, a brief description of the transaction, and any other relevant information.

The assigned APMA consultant (an APMA team leader, economist, or manager) will organize a call with the LB&I TP exam team within two weeks of the email receipt, or at minimum, send an email with a timeframe for the call. The LB&I TP exam team manager has the discretion to include other exam team members and the LB&I directive encourages broader participation as appropriate.

The actual consultation will consider the intercompany transactions and issues under review, with APMA sharing both its general and treaty-specific experience on similar cases, including a discussion of how the competent authority negotiation process will evaluate the facts and arguments presented, and the potential negotiation outcomes. The consult also provides the LB&I TP exam team an opportunity to share its knowledge and experience with APMA, which may help APMA understand taxpayer-specific behavior with treaty partners. The consult should result in an initial view as to whether an adjustment should be pursued. The LB&I directive provides that the LB&I TP exam field team retains responsibility for the selection of examination issues and development, but if the LB&I TP exam team and APMA disagree on whether an adjustment should be pursued, the matter would likely be escalated as needed.

The directive requires a consultation for all transfer pricing exams opened after February 19, 2019, and suggests them for exams in progress.

KPMG Observation

Prior to this directive, KPMG has suggested, on behalf of clients, that LB&I TP exam team confer with APMA on whether a proposed adjustment would be consistent with APMA's current negotiation strategy. In several instances, KPMG's suggested consultation occurred and resulted in the withdrawal of the proposed adjustment. However, KPMG had no authority to compel this consultation. With mandatory consultations, taxpayers and their advisors now have a mechanism to ensure the LB&I TP exam team's proposed adjustment is considered under the competent authority lens early in process, which will potentially save taxpayer resources and curtail adjustments that are inconsistent with the treaty and APMA's negotiation approach. We recommend taxpayers query their LB&I TP exam team on both the timing and results of the consultation.

The information in this article is not intended to be "written advice concerning one or more federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230 because the content is issued for general informational purposes only. The information contained in this article is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author or authors only, and does not necessarily represent the views or professional advice of KPMG LLP.